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Statement of  
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Comptroller General of the United States  
before the  
Committee on Banking, Housing and Urban Affairs  
United States Senate  
on  
[The New York City Seasonal Financing Act of 1975]  
Public Law 94-143

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Mr. Chairman, we are pleased to appear here today to discuss GAO's role under the New York City Seasonal Financing Act of 1975 and to make some preliminary observations on New York City's situation.

The City's adverse financial condition became a matter of widespread concern in March 1975 when it was no longer able to obtain financing in the credit markets to carry itself through periods of cash flow shortages. The New York State Legislature in June of that year created the Municipal Assistance Corporation to provide the City with a temporary source of credit until investor confidence could be restored. After the Corporation's bond issues met resistance, the State legislature in September enacted the New York State Financial Emergency Act. That legislation created the Emergency Financial Control Board and the Office of the Special Deputy State Comptroller for New York City.

As a part of its responsibility under that legislation the Board reviewed and approved a plan to balance New York City's budget by June 30, 1978. The plan, which was approved in October 1975, proposed major budget cuts and Federal assistance in the form of long term Federal loan guarantees to the City. Public Law 94-143 which was passed in December 1975 provided for Federal assistance in the form of seasonal loans of \$2.3 billion. The loans are intended to carry the City through its mid-year cash shortfalls and are to be repaid by the end

of each fiscal year. These loans are administered by the Secretary of the Treasury under a loan agreement calling for periodic reporting by the City, the earmarking of revenues for loan repayments, and diligent pursuit of accounting system reforms.

The Seasonal Financing Act provides for GAO access to the records of both the State and City of New York and provides flexibility on the type and frequency of audits and reports to the Congress. In exercising our audit responsibility it is our intention to avoid duplication of the efforts of other organizations insofar as practicable. A brief description of the roles played by others may be useful in this connection.

City officials in the Mayor's office, Comptroller's office and Management and Budget office are the internal monitors of compliance with the financial plan. They gather basic data and prepare the reports submitted to the Emergency Financial Control Board and the Treasury.

The Board, in addition to its other functions, is the primary external monitor in that it critically assesses the data prepared by the City. The Board is assisted in this work by the Special Deputy State Comptroller and his staff of about 50 professionals most of whom are accountants and auditors. The Special Deputy State Comptroller works closely with the Board and reports on the City's progress and compliance with the plan.

In addition, a separate group of about 85 auditors, as a part of the normal audit function of the Office of the State Comptroller, are auditing City operations. For a number of years this group has been assigned to audits of various agencies of the City on a continuing basis. Their work is not directly and solely related to the current crisis but it does supplement the effort of the Special Deputy State Comptroller to some degree.

Over and above these efforts, the Secretary of the Treasury has responsibility for administering the provisions of the Seasonal Financing Act. He is authorized access to all accounts and other City records and is required, among other things, to determine that there is a reasonable prospect of repayment before loans are made. Treasury was initially assisted by the CPA firm of Arthur Andersen and Co. which it engaged to provide an overview report on information relating to financial requirements under the act. This was accomplished in late December. As an outgrowth of this effort Treasury presently gets a package of 13 reports from the City, most of which are on a monthly basis. These reports are designed to provide a picture of the City's progress against its plan. The first reports were submitted by the City on February 15, 1976, and covered the period through December 31, 1975.

Efforts are underway to design and install an adequate system of accounting and management control for the City.

System improvements were mandated by New York State legislation and by the credit agreement with the Secretary of the Treasury which sets forth the terms and conditions for Federal loans. The City entered into contracts for assistance with the CPA firms of Touche Ross and Co., and Ernst and Ernst as well as the management consulting firm of American Management Systems. The initial contract work to be performed by Touche Ross and American Management Systems was for a design survey and review of the financial structure of New York City. The current contract work being performed by these two firms is for the design and implementation of an integrated financial management system, targeted for completion by July 1, 1977.

Ernst and Ernst, under its contract, is to assist the City in analyzing the existing systems and preparing plans for converting City agencies to the new system being designed by the other two firms. The State Comptroller's office is also participating by issuing accounting system directives with the advice of the CPA firm of Haskins and Sells.

Without a good accounting system in place and functioning, information with respect to the City's financial condition is uncertain at best. The present system is widely recognized as being deficient. Arthur Andersen, in its December 1975 report pointed out that the City's accounting policies are at variance from accepted municipal accounting practices.

It's basic policy was to account for expenditures on a cash basis and revenue on an accrual basis, whether earned or not. This approach does not recognize expenses as they are incurred nor revenues as they are earned and can be distortive of the true financial position.

Designing and installing new accounting systems for a government as large as New York City is a difficult and time consuming task. Therefore, we note with approval that work is also underway to effect interim modifications to the existing accounting systems in key agencies. Touche Ross and Co. is involved in the effort to incorporate fund control and provide for reports which will compare actual versus planned spending, revenue, and cash collections in approximately 20 percent of the City agencies which account for 80 percent of the budget. Suggestions for interim modifications have been developed. They are to be discussed with each affected agency, refined, and put into place by the end of this summer.

In view of the efforts that others have underway we have concluded that our primary role should be an oversight role to avoid unnecessary duplication.

Specifically, we believe that we can best serve the Congress by providing

--an analysis of the actions being taken by the City, State, and Department of the Treasury to put the

City on a sound financial footing and to restore its credit standing in the financial community;

- an independent view of any major financial issues that in our opinion have not been adequately dealt with; and
- any special information and studies that may be indicated or requested.

To accomplish this we have established a special group within GAO to focus on New York's progress and problems. At present we expect to devote 12 to 14 staff-years annually to this project. We plan to report to the Congress later this year after the close of the City's fiscal year and the results of its operations are available. In addition, we will attempt to keep current on the City's progress and developing issues.

We have just begun our work. Our concentration to date has been on trying to sort out the significant issues. We have held discussions with City and State officials as well as others and have reviewed pertinent documents including the City's plan and the various audit reports that have been issued.

In the course of our work, we have made some preliminary observations and raised some questions which we believe are worth bringing to your attention at this time.

The City's October 1975 plan called for budget reductions, on an annual basis, of \$200 million for the year ended June 30, 1976. Since these reductions would not be in place for the

entire fiscal year, the actual cash savings were estimated to be \$92 million through June 30, 1976. The plan also called for additional budget reductions of \$262 million for the year ended June 30, 1977, and another \$262 million for the year ended June 30, 1978. The budget reductions for the last 2 years are planned to be put into effect as of the beginning of each year and therefore, the cash savings should be fully realized for the second and third years.

In February 1976 the City realized that it would have a revenue shortfall and an overrun in expenditures for the plan period, and that it needed to revise its plan. A revision to the plan was prepared and submitted to the Emergency Financial Control Board last Friday, and outlined required budget cuts totaling \$379 million for the second year of the plan and \$442 million for the third year, rather than the \$262 million originally planned in each of those 2 years. In other words, rather than the cumulative required net budget adjustments of \$724 million as originally planned, the City now estimates this amount to be about \$1 billion.

The City began to monitor budget reductions shortly after the adoption of the October 1975 plan. Since that time, some progress has been made but it is difficult to quantify and assess its significance in relation to the financial plan. The City considers an expense reduction completed and a savings accomplished when all required administrative steps have been taken



and the budget has been modified. The Special Deputy State Comptroller, on the other hand, when assessing the City's progress, focuses on when the savings are actually realized. As a result, conflicting reports are being issued. As of late January, for example, the City maintained that it was 82 percent on target while the State reported that only 39 percent of the reductions were on target. By either measurement technique, the City is behind schedule.

It is too early for us to predict whether the City will catch up and comply with the 3-year plan. The City is considering dropping out of the social security system as of March 31, 1978, an action which would save an estimated \$43 million in the third year of the plan and an estimated \$130 million a year thereafter. The City is also proposing turning over a part of the City university system to the State as a means of achieving a savings of \$36 million in the second year and \$113 million in the third year of the plan and thereafter. When finally implemented major changes of this type, which were not a part of the original plan, may permit the City to meet its original goal.

The City's ability to implement a new accounting system by July 1, 1977, is another serious matter. Arthur Andersen and Co. observed that prospects for meeting that deadline were "doubtful". City officials and the consultants maintain that the target date for system implementation can be met

with the possible exception of the payroll and personnel subsystem which may slip by 6 months. Implementation of the new system by July 1, 1977, is a very ambitious undertaking in view of the complexities associated with the City's fiscal operations and the magnitude of the personnel training requirement. We understand that more than 10,000 personnel are involved in the City's financial management systems. No one can state with certainty whether or not the City will meet its target date, but it is clear that the City is confronted with a monumental task and an intensive high-priority effort will be required.

We are concerned about the City's progress and adherence to the financial plan. However, we are equally concerned whether such adherence will necessarily result in a balanced budget in future years and the restoration of investor confidence.

I would like to briefly discuss our concerns.

1. Significant debt in moratorium

Toward the end of 1975 about \$2.6 billion in City short term notes were outstanding and imminently due. About \$1.6 billion was publicly held and the balance was held by institutions. Since the City could not redeem the notes the holders were offered the option of converting to other securities.

Some did convert, but \$941 million in publicly held debt and \$1 billion in institutionally held debt was not converted

and payment of the debt was deferred by State legislation. The publicly held debt is to be repaid in November 1978 and the institutional debt will be repaid in installments between 1978 and 1986.

The \$941 million obligation coming due immediately after the period covered by the plan and the subsequent \$1 billion obligation will adversely affect the City's ability to operate with a balanced budget in periods subsequent to June 30, 1978. The financial plan does not make provision for accumulating funds for repayment of either amount.

## 2. Wage freeze

The 3-year plan provides that there will be no wage increases or cost of living adjustments beyond 1976. Adherence to this provision is crucial to the plan. Assuming the City succeeds in this effort, it could be confronted with pressure for significant catch up increases in the 4th year which would in turn adversely affect the City's financial position.

Moreover, if no increases are granted and the City's pay structure falls 3 years behind the competitive market, the City could lose some of its more valuable employees who might become disenchanted with a frozen pay structure. In addition, a frozen pay structure could be a disincentive at a time when the City most needs increased productivity.

### 3. Operating expenses in capital budget

For a number of years the City has been funding some operating expenses through its capital budget. In the year the plan was drawn up this amount approximated \$700 million. The plan provided for shifting \$30 million in expenses back to the operating budget in 1976. The balance of about \$670 million will be shifted back over a 10-year period.

The effect of showing operating expenses in the capital budget is to understate the expenses in the operating budget and obscure the City's progress in achieving a balanced budget.

### 4. Pensions

There is also a question as to whether the City's pension costs may be understated. A City commission is currently studying the problems, and its report is due shortly. If the commission finds that the City has, in fact, significantly underfunded its pension system, increased contributions may be required. These would place an additional burden on the City and the plan.

### 5. State and Federal aid

The City's plan assumes State and Federal aid at certain levels but there is no assurance that these amounts will be received as planned. The City's analysis of the proposed State budget for the year ending March 31, 1977, indicated that State aid to the City would be reduced by about \$139 million and that the proposed fiscal year 1977 Federal budget would result in further reductions of about \$163 million.

These amounts may change, of course, but their significance lies in the fact that they are beyond the City's control and they may require further expense reductions which were not planned.

6. Welfare costs

The City's plan assumed that the cost of welfare and medicaid programs would remain constant throughout the plan period. The City has already had to revise this estimate to make provisions for increases of \$50 million, \$62 million, and \$62 million in the first, second, and third years respectively.

As with State and Federal aid, the expense of the welfare and medicaid programs is beyond the City's control because of an increasing caseload and legislative mandate.

7. Need for economic forecast

Finally, there is another area which causes us concern. The City's planned budget cuts are deep and extensive and they are coming at a time when reported economic indicators point to other problems for the City. For example:

- The Bureau of Labor Statistics reported that 143,000 jobs were lost in New York City last year. This represents a drop of 4.1 percent.
- The State Urban Development Corporation reports that about 21,000 housing units are being abandoned yearly in the City.

--New York City's economists report that the number of businesses in the City has declined by about 12,000 since 1969. This represents a drop of 6.3 percent.

--A private real estate organization reported that approximately 12 percent of the available office space in the City is vacant. This equals almost as much as the total office space in Philadelphia.

The current New York City crisis could be of long duration because of a number of persistent problems related to its underlying economic base. If that is the case, there is a need to forecast the economic base of the City 5, 10, or 15 years in the future.

On the basis of our inquiries to date, we have not identified any effort to develop a comprehensive long-range analysis of New York City's economy. We believe such analysis is important in terms of developing a long-range solution to the City's problems or at least laying out the long-range considerations.

We are planning to develop a report by this Fall that identifies the economic issues that underly the New York City financial situation and that should be studied in depth. Since the financial viability of the City is so closely related to the economic health of the region, we believe that it is necessary to discuss the economic problems of the New York region and relate them to the budgetary revenues

and expenditures of the City. We believe that by raising these issues, it may be possible to design, at a later date, a comprehensive model that could explore the financial stability of the City and its ability to obtain financing in credit markets over the next 5, 10, or 15 years.

This report would also discuss the issues involved in attempting to achieve a balanced budget and what role, if any, the Federal Government might play in providing financial aid to New York.

Mr. Chairman, we have raised a number of questions today. Even though our work is preliminary at this stage, the combined impact of these questions causes us to be concerned about whether the current financial plan for New York is a realistic one. Perhaps it is not too early to consider the need for a more realistic and comprehensive plan, even if it indicates the need for some changes in the projected roles and responsibilities of all the parties.

This concludes our prepared statement, Mr. Chairman. We will be happy to respond to any questions you may have.